Subject: 2007 M2M and DEMO Accounting Q&A’s  
Full Restructuring Financial Reporting and Compliance

Dear (Owner/Agent) and/or Owner’s Accountant:

Background. HUD’s Office of Affordable Housing Preservation (OAHP) administers the Mark to Market (M2M) program, including oversight of the portfolio of HUD-held Mortgage Restructuring Notes (“MRNs”) and Contingent Repayment Notes (“CRNs”), and administration of the portfolio of subordinate notes created under the Portfolio Reengineering Demonstration Program (“DEMO Notes”). In this capacity, OAHP and HUD’s Post-Closing Portfolio Management (PCPM) contractor, RER Solutions, Inc., routinely review post-restructuring property operations and financial reporting and document that review in HUD’s Surplus Cash Analysis (SCA).

Unique accounting issues associated with this portfolio are addressed below. Letters covering important new topics in post-M2M accounting have been sent each of the past three years. HUD plans to consolidate that guidance into a searchable website in the near future and will notify owners, accountants, and HUD staff when this new resource is available. Accounting issues unique to the DEMOs, which were not applicable to M2M, were addressed in a separate DEMO guidance letter in 2006. However, when the entire DEMO portfolio began using only a surplus cash computation last year, those distinctions were lessened. DEMO Owners and accountants are strongly encouraged to review the 2006 DEMO accounting letter if unfamiliar with those changes. Any questions unique to DEMO property accounting will be clearly noted in the answers below.

Purpose. We trust that this letter will be equally valuable to owners and accountants. Information in the preceding accounting letters continues to be applicable except as noted below. Please go to OAHP’s web site for the earlier letters at http://www.hud.gov/offices/hsg/omhar/mhowner.cfm.
1. Q: If a property with M2M or DEMO debt is sold, can the subordinate debt be assumed or is the entire debt due on sale? Can the subordinate debt be transferred to the new owner via warranty deed, subject to the existing (original) M2M or DEMO notes, mortgages, Regulatory Agreements and Use Agreements in lieu of mod/assumption documents? Who needs copies of the transfer documents?

A: M2M and DEMO notes are due on sale or refinance and MAY NOT be assumed without prior approval of HUD; contact your HUD PM for guidance. Assumption approval is not automatic, if granted typically will require partial pay down of the subordinate debt and ALWAYS requires execution of M2M or DEMO modification and assumption documents by the buyer, seller and HUD. Transfer of ownership subject to the existing (original) legal documents places unacceptable conditions on the title and violates the terms of the M2M/DEMO Notes and Regulatory Agreements.

If HUD approval is granted, copies of the following documents must be forwarded to HUD MF Notes Servicing Branch, (attention Debbie Courtright), PO Box 44804 W, Washington DC 20026-4804 immediately after a new owner takes title: executed (recorded, if applicable) documents assuming the M2M or DEMO Notes, Mortgages, Regulatory Agreements (and Riders) and Use Agreements, and a signed W-9 providing the new owner's tax ID. Any terms and conditions of the assumption approval must be incorporated into the legal documents (e.g., elimination of Capital Recovery Payment (CRP), subordination of the M2M/DEMO Notes to a new first subject to prescribed terms and conditions, etc.).

2. Q: How is the annual payment on M2M or DEMO notes calculated in the year of an approved TPA? Is the annual payment amount allocated between the buyer and seller based on their partial year AFS submissions? When is the seller's payment due?

A: M2M and DEMO Notes require payment based on the annual surplus cash computation. HUD requires that the buyer and seller each submit partial year AFSs for the year of a sale in FASS. Currently, under the terms of the Note the annual loan payment is not due until after the end of the fiscal year. To preclude disputes between HUD, sellers and purchasers regarding payments in the year of a TPA, HUD requires, as a condition of approval for all TPAs involving assumption, subordination, assignment or forgiveness of the M2M/DEMO debt, that the Seller pay their prorata share of the annual payment amount (as determined by HUD) at the time of the sale. The Seller must provide interim financial statements, including a computation of surplus cash, to the HUD Field Office with a copy to OAHP as part of the request for HUD approval for all TPAs involving assumption, subordination, assignment or forgiveness of M2M/DEMO debt. The HUD Field Office will work with OAHP to determine the required payment amount for the partial year ending on the closing date. The purchaser will file its partial year AFS after the end of the fiscal year, and is responsible to make payment to the holder of the notes (generally HUD) from the year-end Surplus Cash.

3. Q: A property that went through a M2M full restructuring was sold to a Qualified Non-Profit and was approved for “debt relief”. The insured first mortgage remained in place; what FASS accounting templates should the new owner use in filing AFS?

A: Qualified Non-Profit owners that received debt assignment or modification (for any M2M debt) must file in FASS using the M2M FASS templates. As long as a M2M Rider(s) to the Regulatory Agreement is still in place, the M2M templates must be used. The M2M Regulatory
Agreements and Riders remain in place and thus the M2M templates are needed for the QNP to access the unique M2M distributions. **Qualified Non-Profit** owners that received **debt forgiveness** (for all M2M debt) must file in FASS based on the requirements of the underlying form of Regulatory Agreement, they no longer use the M2M templates. With M2M debt forgiveness, the M2M Regulatory Agreements, and the Riders to those Regulatory Agreements were released, so the M2M templates are no longer used.

4. **Q:** When a TPA occurs at the same time as the M2M closing, the seller and buyer must both file partial year AFS submissions in FASS. But once the M2M closing date has been entered the seller can’t access the standard FASS templates for filing. The Real Estate Assessment Center (REAC) FASS system presents both the seller and buyer the M2M Surplus Cash template. How can the seller access the correct templates for the period prior to restructuring? (The 2006 accounting letter addressed a related question for the buyer).

**A:** A FASS upgrade is anticipated in late spring 2007 which will address this, but in the interim, contact your HUD Project Manager and ask that they contact REAC’s Technical Assistance Center at [http://www.hud.gov/offices/reac/contactus/fass-mfh.cfm](http://www.hud.gov/offices/reac/contactus/fass-mfh.cfm) or by phone at (888-245-4860) for assistance accessing the standard FASS template for the seller’s partial year submission.

5. **Q:** Question 5 in the 2006 M2M accounting letter addressed problems a purchaser has in accessing the M2M accounts in the FASS templates when a transfer/sale occurs subsequent to the M2M closing. Since modification and assumption of the legal documents is a requirement for any HUD approved assumption, the answer to Question 5 is amended below to incorporate HUD's requirement for confirmation that executed modification/assumption documents for the M2M or DEMO loans are on file.

**A:** First contact your local HUD Project Manager and ask that they confirm that the Real Estate Management System (REMS) has been updated with your Tax Identification number, your date of acquisition (“FASS Date”), your fiscal year end date (such as December 31), and any other data that affect FASS. Also be sure that your “FASS Coordinator” has been properly registered with REAC. Applicable submission and registration rules are contained in the FASS Industry User Guide available at the REAC website at: [http://www.hud.gov/offices/reac/products/fass/fassmf_guideChanges.cfm](http://www.hud.gov/offices/reac/products/fass/fassmf_guideChanges.cfm). Then confirm that the owner of record in the Notes and other legal documents matches the owner data in FASS. If they do not match, provide copies of the required modification/assumption documentation (see #1 above) prior to requesting filing assistance.

6. **Q:** We are an owner of a DEMO property that filed AFS using the note terms (Net Cash) for years prior to 12/31/05. Our HUD Project Manager and the PCPM contractor contacted us recently with questions about our calculations of DEMO loan payment amounts for those prior years. They are questioning our deduction from Net Cash of actual hazard insurance and property tax expenses **AND** deposits to HUD required escrows for property insurance and taxes. *My DEMO Note lists those escrow deposits as eligible operating expense. What is the problem?*

**A:** Certain DEMO notes defined “Net Cash” so as to allow owners to deduct the greater of the annual deposit to those escrows or the actual expenses incurred in the year. Your approach,
deducting both these amounts, overstates your expenses, understates Net Cash and is not acceptable. HUD’s PCPM contractor will make the appropriate adjustments in the final Surplus Cash Analysis and report the required revisions to you directly.

7. **Q:** Is it true that upon maturity, any outstanding balance on the M2M/DEMO notes will be forgiven by HUD?

A: No. The remaining principal balance, accrued interest and fees, are due upon maturity of the M2M/DEMO notes. Occasionally we see inaccurate comments in the Notes to Financial Statement indicating that upon maturity, HUD will forgive any outstanding balance on the M2M/DEMO notes. Owners and accountants should carefully review the terms of the Note and rely only on the terms and conditions of the loan documents.

8. **Q:** If a property did not meet the pre-conditions for CRPs during all of 2006 and did not make any of the payments, should the current portion of the note include just the twelve payments that should have been made during 2006, or should the current portion include the twelve 2006 payments plus the twelve 2007 payments? (We understand that no additional interest may be charged for these accrued payments, and that since they still have not met the pre-conditions, the liability to make the payments will not be included on the Surplus Cash schedule.)

A: Question #7 in the 2005 letter responded partially to this question. We repeat the earlier answer below and provide additional comments to further clarify.

- In the AFS, the owner’s investment (on which the CRPs provide a return) is treated as a loan, with the interest rate and term determined in the M2M underwriting. Each monthly payment is treated as having principal and interest portions.
- CRP payments made during a fiscal year are reported on the **Statement of Cash Flows** in FASS accounts S1200-417 (principal portion) and S1200-195 (interest portion).
- On the **Balance Sheet**, at the end of a fiscal year, the loan will have a remaining principal balance (some of which is to be paid within twelve months and is reflected as a current liability in FASS account 2179, with the balance being a long term liability in FASS account 2329). If any payments have become due (eligible) but have not been paid as of fiscal year end, there will also be accrued interest payable, which should be shown in FASS account 2139 – Accrued Interest Payable – Capital Recovery Payment (M2M).
- The current principal portion of the CRP (FASS account 2179) would include principal payments due within the next twelve months and the principal portion of any back payments that the owner was unable to pay due to the preconditions not being met.
- In the **Computation of Surplus Cash**, CRP payments that are due but that have not been paid may be included as Other Obligations only if, as of fiscal year end, the preconditions for payment had been satisfied.

9. **Q:** CRP payments were not made for 2 years because a property did not meet the preconditions. The property has now satisfied the preconditions. May the project now pay all unpaid CRP payments? Or should they just resume making the monthly CRPs starting from the point at which they have met the pre-conditions?

A: Yes, they may make all accrued back payments, subject to the availability of cash.
10. **Q:** An owner earns an Incentive Performance Fee (IPF) of $5,000 for 2006 (and there is surplus cash to pay it). If the owner chooses not to take the fee in 2007 does he permanently forfeit the money? Does the $5,000 become part of surplus cash at 12/31/07 or can the owner set up an account payable for $5,000 and include it as an obligation on the 2007 computation of surplus cash?

**A:** It is not acceptable to set up an account payable and include IPF as an obligation on the 2007 computation of surplus cash. Owners must either take the distribution or deposit the funds into a separate entity cash account or it becomes part of surplus cash at the end of the next fiscal year.

11. **Q:** Are owners with delinquent M2M and DEMO loan payments being reported to the credit reporting agencies?

**A:** Yes, HUD requires that delinquencies on all HUD-held debt be reported to the credit reporting agencies quarterly (annual payments are due within 10 days of filing AFS).

12. **Q:** As a result of HUD's review of the Surplus Cash Analyses for my property for 2004 and 2005, HUD required I repay ineligible CRP payments to the project account. But other feedback I received from FASS and REAC staff about my AFS did not require any such adjustments. How do these reviews and requirements get reconciled?

**A:** Conditions addressed in final Surplus Cash Analyses are requirements of HUD and must be complied with, without regard to whether other HUD correspondence includes a similar requirement. HUD conducts a separate detailed review of Surplus Cash Analyses on M2M and DEMO properties after the AFS screening reviews by REAC and FASS systems and staff. In the future, items noted in final SCA reports are more likely to be reflected in FASS' automated screening reviews, as REAC/FASS staff recently implemented changes to FASS that will flag owner failure to make required MRN payments, overpayment of the IPF, and excessive owner distributions. Further, a summary report of prior year SCA conditions is being provided HUD Project Managers for use when screening AFS' for subsequent filing periods for compliance. (Examples of conditions include a requirement that the owner repay funds to the project account for ineligible CRP, IPF, or other distributions or make a supplemental payment to HUD on those Notes.)

13. **Q:** Where do I send my annual M2M or DEMO loan payments? I heard the address recently changed.

**A:** The address for HUD’s lockbox for receipt of payments on HUD-held notes changed effective 12/20/2006 and is provided below. Be sure to include a transmittal letter/memo identifying the property name, FHA loan number and provide a contact person’s name and phone number.

- For **regular mail** deliveries send payments with a transmittal identifying project name, FHA number, and how funds are to be applied, to the following address:
  
  HUD - Multifamily Mortgage Notes
  
  P O Box 530256
  
  Atlanta, GA 30353-0256

- For **overnight deliveries** send payments with a transmittal which includes the entire address below, in addition to project name, FHA number, and how funds are to be applied, to the following address:
The telephone number to enter for the recipient on the overnight label is (404) 209-6187.

For Additional Information: This guidance is offered as a resource for post-M2M and DEMO owners and their accountants and addresses specific accounting requirements for those transactions. If you have other M2M accounting related questions, please review the previously issued accounting letters at OAHP’s web site http://www.hud.gov/offices/hsg/omhar/mhowner.cfm. Please submit property specific or general questions to the OAHP Resource Desk at resourcedeskweb@oahp.net. You may also direct questions to Jo Anne Garrison, or Mike Murphy of my staff by telephone at (202)708-0001. For more information on M2M, visit the OAHP website at http://www.hud.gov/offices/hsg/omhar/.

For questions specific to the filing of regarding financial statements filing via the FASS system, contact the REAC Technical Assistance Center (TAC) at 800-245-4860 or http://www.hud.gov/offices/reae/support/tac.cfm.

Sincerely,

s/ electronic signature in doc

Theodore K. Toon
Deputy Assistant Secretary
Office of Affordable Housing Preservation

CC: Project accountants identified in FASS via email